FIORI FINANCIAL GROUP

October 2019

FFG Market Pulse

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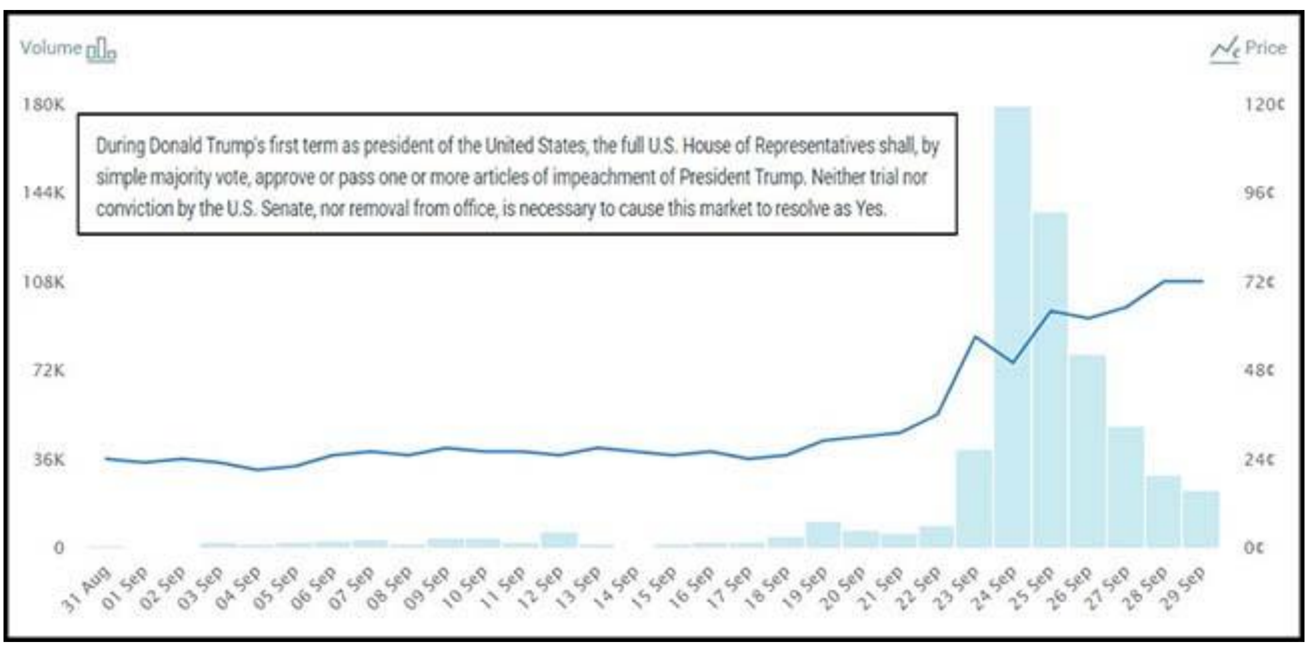
It is amazing to think that we are already in October and going into the 4th quarter of the year. It seems time just flies. Even as time seems to be moving quickly, many times things stay the same. Looking back at our last quarters edition, there hasn't been a whole heck of a lot of change in the financial world.   Trade War Rhetoric, The Federal Reserve, Interest Rates and Politics still are the main drivers. All of these factors that have sustained the front consciousness of the world have led us to look through our prism with a more cautious outlook. Over the past many months, we have taken some measures to begin to lower our portfolio volatility metrics. We have increased our percentage allocation to cash, gold and convertible bonds to assist with mitigating any potential volatility. With that said, we still believe that the US consumer currently remains on solid footing in the very near term given that unemployment remains historically low, jobless claim numbers have not increased, inflation remains relatively muted, and gas prices remain contained. The US consumer has been by far the strongest and most important pillar in the US economy as it makes up 70% of our economic activity.   However, the US consumer simply cannot do all of the heavy lifting in the global economy. Economic data in places in China and Europe has been clearly been slowing for a couple of quarters now, especially on the manufacturing side, mainly due to tariffs and overall trade war uncertainty. At some point, if there is not a resumption in global trade then inevitably the global slowdown will eventually hit the US economy either through reduced consumer spending, cutbacks in US corporate spend or both.

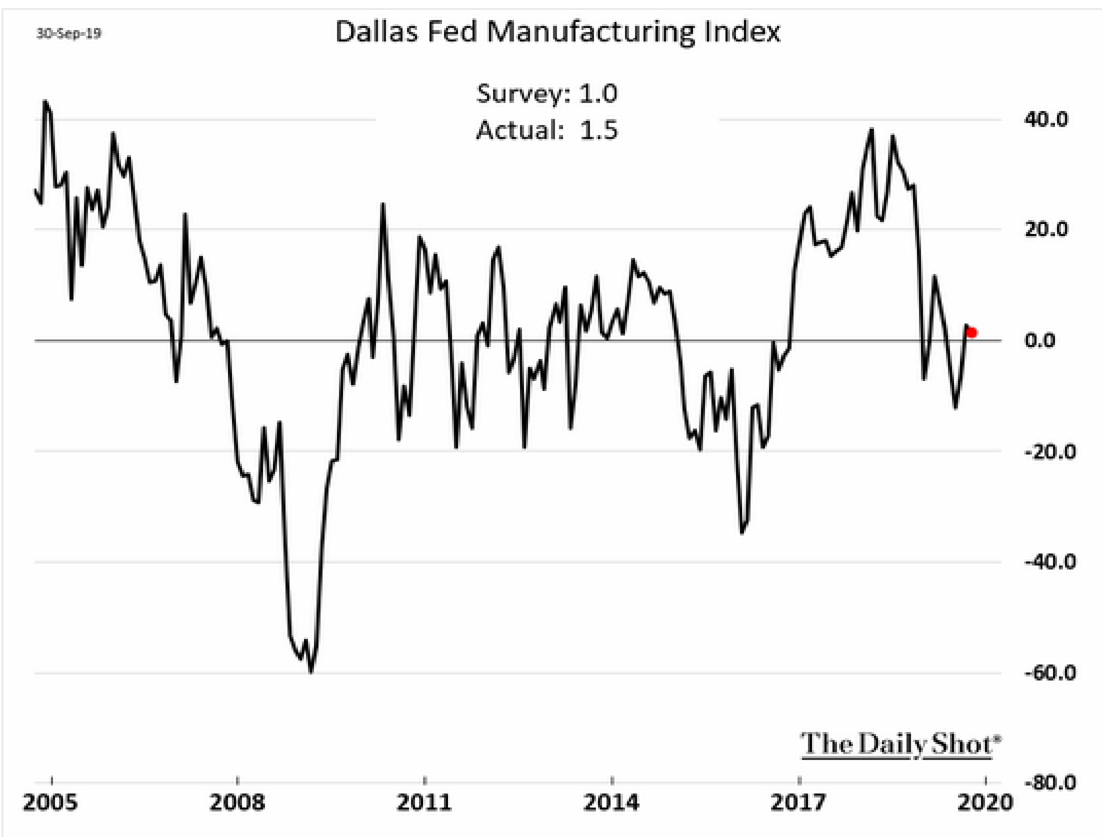
CHART(S) OF THE MONTH

First from the political world. This chart shows that over the past weekend odds for a House impeachment vote moved to 70%, while public opinion for impeachment moved into the high 40% range.

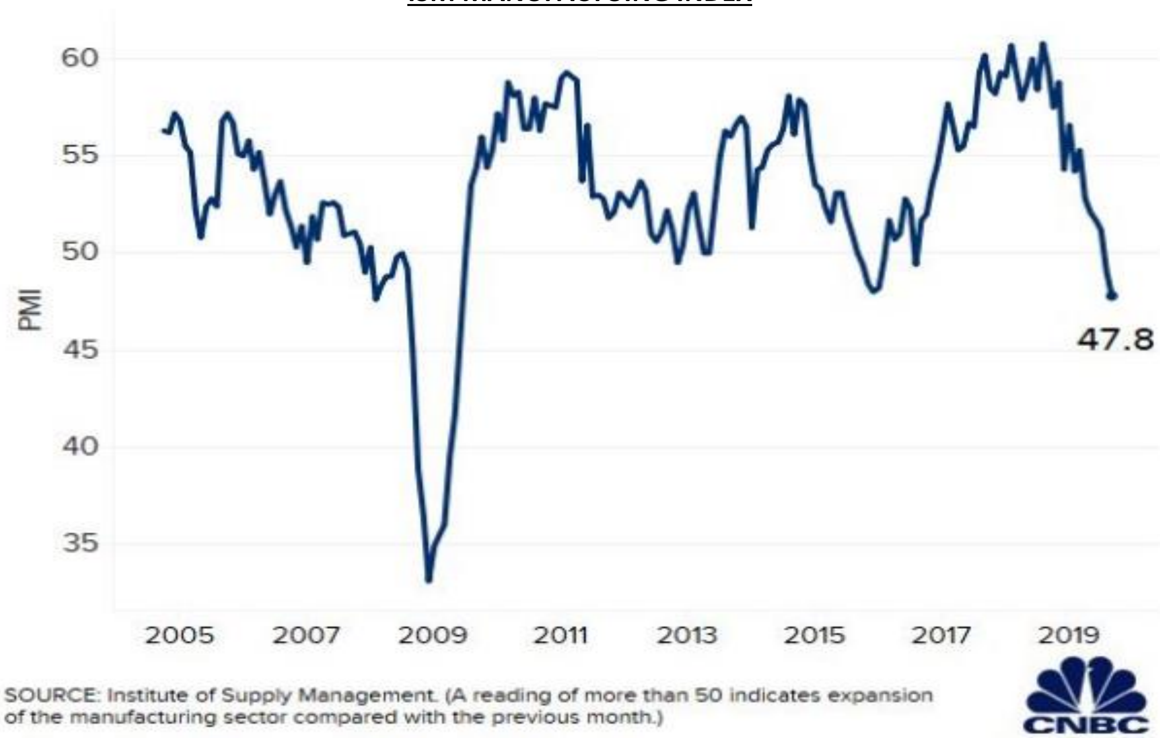


What does this mean really? Here is how the impeachment process works. The next steps will be a series of hearings, the potential drafting/passage of articles of impeachment in the committee with only a simple majority needed, then floor consideration in the House (again simple majority). Should the House vote to impeach, the Senate current rules require the Senate to hold a trial, with a 2/3 threshold required for conviction/removal of the president. The current makeup of the Senate (53 Republicans, 47 Democrats), makes it extremely unlikely to meet the 2/3 threshold needed for removal.   An important note is that the Senate has never removed a president in the history of our country.   Presidents Andrew Johnson and Bill Clinton are the only presidents to be impeached and both were acquitted in Senate trial. President Richard Nixon, whose tenure ended because of the Watergate scandal, resigned from office before impeachment ever came to a vote.   The effect on the market has been muted because of the very slim chances of an actual presidential office removal.

Next up is some economic data. Here's a day to day example on how economic data looks very much like a mixed bag. The first 2 charts are September's recent regional manufacturing indexes from Fed's of Dallas and Philadelphia. These first 2 charts were released just this week.   Both show softening but still show expansion and nowhere near multi year lows. The third chart is the ISM Manufacturing Index which was just released today as of this writing and shows a much larger slowdown along with multi year low.   You can never make an investment thesis on 1 chart or 1 data point.   All data must be scrubbed and analyzed before making decisions. That is what we do. Hence the philosophy to remain diligent and seek slightly lower volatility metrics to fit the current mixed landscape.

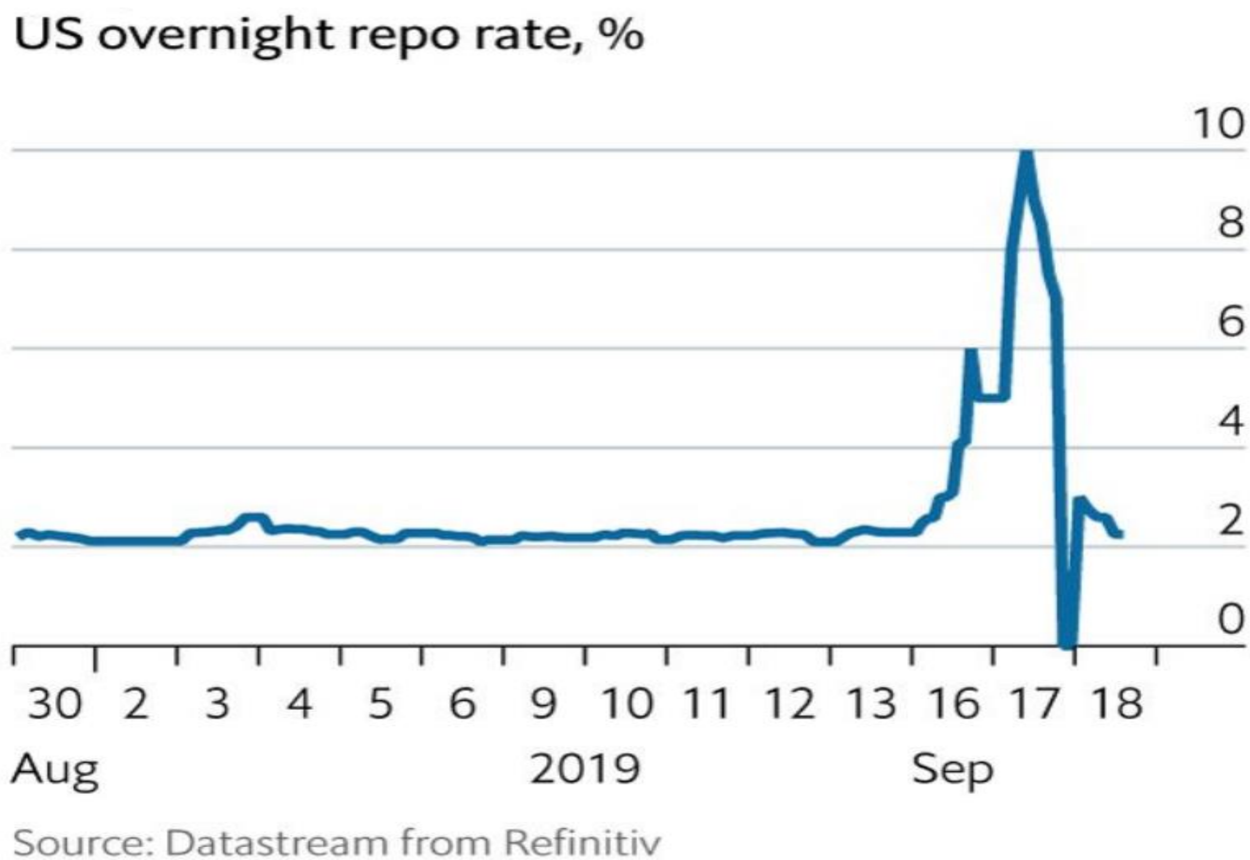


ISM MANUFACTUING INDEX



Lastly, we will take a look at a more recent phenomenon that took place with overnight bank lending rates in September. You may have heard something on the news about the Repo market. Allow me to explain what this is. REPO's or repurchase agreements are collateralized loans. These transactions occur between banks but often involve other non-bank financial institutions such as insurance companies. Repos can be negotiated on an overnight basis. You can think of this as the plumbing of our financial system. This type of borrowing is the engine that allows the financial system to run smoothly. Banks routinely borrow and lend to each other on an overnight basis to ensure that all banks have ample funds to meet daily cash flow needs and that banks with excess funds can earn interest on them. Typically, the banks charge a rate that is close to the Federal funds rate as interest. This rate was right around 2%.

Just about 2 weeks ago, the interest rate on overnight loans spiked to closer to 10%



Here is another way to look at this using a real-world example. Imagine approaching a friend that you think is very wealthy and asking her to borrow ten thousand dollars for just one night. To entice her, you offer as collateral the title to your 2019 Lexus parked in her driveway along with an interest rate that is 5% above that which she is earning in the bank. Shockingly, your friend says she can't. Given the risk-free nature of the transaction and excellent one-day profit, we can assume that our friend must be short on cash. That is what happened with the overnight Repo market. There wasn't enough cash to go around.

Why did this happen? There is no definitive answer but most economist believe that different events acting as catalysts just happened to land at the same time. A big swath of new Treasury debt settled into the marketplace, landing on dealers' balance sheets just as cash was being sucked out by quarterly tax payments companies needed to send to the government. Then add in the factor of years of far more restrictive reserve ratio requirements that banks must adhere to. This caused a large shortage of overnight funds which drastically spiked the interest rates on overnight loans.

The Federal Reserve responded quickly by offering multiple days of billions of dollars per day infusions into the Repo market to address the liquidity problem. Rates have come back down to normal levels but this is something to monitor as not just a one off event. Attention in the coming days and weeks will be on whether the New York Fed maintains its presence in the market, after it conducted those two-week series of injections. Focus will also shift to the end of the year, when banks are even more constrained to supply cash to the repo market because of further regulatory reporting dates.

As of now, things appear to back to normal with overnight rates given the FED's action. However, this is something we will continue to monitor as the flow and movement of cash and credit is vital to our economy.

RODNEY DANGERFIELD ONE LINER OF THE MONTH

What a doctor I got. I saw him, I told him, "Doc, I broke my arm in two places." He told me to keep out of those places."